REPORT OF THE

ASSOCIATION FINANCIAL EXAMINATION OF

SHELTER GENERAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

STATE OF MISSOURI

DEPARTMENT OF INSURANCE

JEFFERSON CITY, MISSOURI

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Columbia, Missouri
June 12, 2006

Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance
Chairman, Financial Condition (E) Committee

Honorable Jorge Gomez, Commissioner
Wisconsin Department of Insurance
Secretary, Midwestern Zone, NAIC

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Shelter General Insurance Company

hereinafter referred to as such, as Shelter General, or as the Company. Its administrative office is located at 1817 West Broadway, Columbia, Missouri 65218, telephone number 573-445-8441. This examination began on June 6, 2005, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Shelter General was made as of December 31, 2001, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with no other zones participating.

The current full scope association financial examination covered the period from January 1, 2002, through December 31, 2004, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating.

The current full scope association financial examination covered the period from January 1, 2002, through December 31, 2004, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating.

This examination was conducted concurrently with the examinations of the Company's parent, Shelter Mutual Insurance Company (Shelter Mutual), and its affiliates, Shelter Life Insurance Company (Shelter Life), and Shelter Reinsurance Company (Shelter Reinsurance). Shelter Mutual and its insurance subsidiaries are collectively referred to as the Shelter Insurance Companies in this report.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, Ernst & Young, LLP, of Kansas City, Missouri, for its audit covering the period from January 1, 2004, through December 31, 2004. Information relied upon included attorney letters, tests of controls, and narrative descriptions of processes and controls.

COMMENTS – PREVIOUS EXAMINATION

The previous financial examination of Shelter General was conducted by the MDI for the period ending December 31, 2001. Listed below are the comments, recommendations, and notes from the previous examination report, the Company's response, and the findings in the current examination.

Intercompany Transactions with Shelter Mutual

Comment: It was noted that Shelter General does not have a written agreement with Shelter Mutual for the management services and facilities that are provided by Shelter Mutual and the associated costs to be allocated under the Joint Expense Allocation Agreement. The Company was directed to obtain a written agreement with Shelter Mutual, similar to the Management Services and Facilities Agreements that exist between Shelter Mutual and other subsidiaries. Such agreement should be submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Company's Response: The Company stated that Shelter General filed an Agreement for Management Services and Facilities as a Form D filing with the MDI in October 2003 and it was approved.

Current Findings: Shelter General has an Agreement for Management Services and Facilities with Shelter Mutual that is nearly identical to the Agreements that exist for Shelter Mutual's other subsidiaries. Refer to the Intercompany Agreements section of this report for further information.

Joint Reinsurance Agreements with Shelter Mutual

Comment: It was noted that Shelter General and Shelter Mutual have several joint reinsurance agreements. Shelter General does not directly pay reinsurance premiums to the reinsurers and does not directly receive loss recoveries. Shelter General is allocated reinsurance premiums and loss recoveries, but there was no written intercompany agreement for this arrangement. Shelter General was directed to obtain an intercompany agreement with Shelter Mutual for the allocation of reinsurance premiums and loss recoveries for the joint reinsurance agreements. Such agreement should be submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Company's Response: The Company stated that it disagreed with this comment. It further stated that Shelter General is not allocated premiums or losses, rather premiums are calculated based exactly as the reinsurance contracts specify and the losses are reimbursed exactly as they are incurred. Shelter Mutual performs only a clearing function for the transfer of premium payments to the reinsurer and recoveries to Shelter General.

Current Findings: The Joint Expense Allocation Agreement between Shelter Mutual, Shelter General, and other affiliates was amended and restated effective December 1, 2004 for the purpose of adding a section for the allocation of reinsurance premiums and loss recoveries. This was deemed sufficient to comply with the prior examination comment.

Reinsurance Agreement with ERC

Comment: It was stated that the Company's excess reinsurance agreement with Employers Reinsurance Corporation (ERC), originally effective January 1, 1975, is disjointed and has confusing terminology. The 44 amendments to this agreement could not be tied to the body of the original agreement in any coherent manner. As a result, the reinsured lines of business, the Company's retention, and the reinsurance limits are not clearly defined. It was recommended that this agreement should be restated in its entirety so that the reinsured lines of business, retentions, and limits are clearly defined.

Company's Response: The Company stated that as of October 31, 2003, it obtained from ERC a binder containing the agreement language and its amendments that reflect in an organized manner, the Company's current placement.

Current Findings: The only attempt made by the Company to organize the ERC agreement and the numerous amendments was that handwritten notations were added to the documents to clarify the terms. These notations were not sufficient and another recommendation for this problem is included in the Reinsurance section of this report.

Missing Claim Files

Comment: It was noted that the Company was unable to locate three claim files and several months of research were required to locate other claim files for a statistical sample of the paid claims data supporting Schedule P of the Annual Statement. The Company appeared to have numerous claim files that were either missing or improperly filed based upon the results of this sample. Section 374.205.2(2) RSMo (Examination of Insurers) requires insurers to maintain claim files for the year in which the claim is closed, plus 3 calendar years. It was recommended that the Company review its procedures for the filing, maintenance, and retention of claim files and improve these procedures to ensure that all claim files are retained in accordance with the cited law.

Company's Response: The Company stated that they were only unable to locate one claim file.

Current Findings: A similar statistical sample of paid claims data was conducted in the current examination and several claim files were requested for review. Claim files were provided on a timely basis and only one claim file could not be located, which was not deemed to be a significant problem.

Pooled Investments

Comment: It was noted that commercial paper investments of Shelter Mutual, Shelter General, and Shelter Life were commingled in a single investment account with Merrill Lynch. However, Shelter General did not have a pooling agreement with Shelter Mutual or Shelter Life, as required by Section 379.083 RSMo (Investment Pools). The Company was directed to immediately submit a pooling agreement to the MDI for prior approval, as required by Section 379.083 RSMo, and ensure that the agreement complies with this statute.

Company's Response: The Company stated that it complied with the alternative option of establishing separate bank accounts for each entity.

Current Findings: The Company did not have any pooled investments, as of December 31, 2004.

HISTORY

General

Shelter General was incorporated and commenced business on November 12, 1957. The Company was originally named Countryside Casualty Company. The Company's name was changed to Shelter General Insurance Company on July 1, 1981. The Company operates as a stock property and casualty insurer under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life).

Capital Stock

Shelter General is owned 100% by Shelter Mutual. The Company is authorized to issue 1,250,000 shares of common stock with a par value of $1 per share. As of December 31, 2004, all 1,250,000 shares were issued and outstanding for a total capital stock balance of $1,250,000.

Dividends

The Company paid a $5,000,000 cash dividend to Shelter Mutual in 2004. No dividends or cash distributions were paid or declared during 2002 or 2003.

Management

The management of the Company is vested in a Board of Directors that are appointed by the sole shareholder, Shelter Mutual. The Company's Articles of Incorporation and Bylaws specify that the number of directors shall be nine. The Board of Directors appointed and serving, as of December 31, 2004, were as follows:

Name and Address	Principal Occupation and Business Affiliation
James A. Offutt* Osage Beach, MO	Chairman, Retired Executive Shelter Insurance Companies
J. Donald Duello* Rocheport, MO	Vice Chairman, President and CEO Shelter Insurance Companies
Gerald T. Brouder Columbia, MO	President Columbia College
H. Marshall Chatfield Columbia, MO	Retired Executive Kansas City Life Insurance Company
Ann K. Covington* Columbia, MO	Attorney / Partner Bryan Cave, LLP
Andres Jimenez Madrid, Spain	Vice President and Chief Executive Officer Mapfre Re Compania de Reaseguros, S.A.
Raymond E. Jones** Columbia, MO	Executive Vice President and Secretary Shelter Insurance Companies
Don A. McCubbin Sturgeon, MO	Executive Vice President Shelter Insurance Companies
Barry L. McKuin Morrilton, AR	President Morrilton Area Chamber of Commerce

* The following changes occurred, effective November 19, 2005: Mr. Offutt retired and was replaced as a Board member by J. David Moore. Mr. Moore was elected as President and Chief Operating Officer. Mr. Duello was elected as the Chairman of the Board. Ms. Covington was elected as the Vice Chairman of the Board.

** Mr. Jones retired as an employee in April 2006, but remains a director.

Committees

The Bylaws require an Executive and Compensation Committee, Audit Committee, and an Investment Committee of the Board of Directors. The Bylaws also allow for other committees to be appointed by the Board of Directors as needed. As of December 31, 2004, the members of each committee were as follows:

Executive and Compensation Committee
Ann K. Covington, Chairman
J. Donald Duello
H. Marshall Chatfield
James A. Offutt
Gerald T. Brouder

Audit Committee
Barry L. McKuin, Chairman
Ann K. Covington
H. Marshall Chatfield

Investment Committee
J. Donald Duello, Chairman
Raymond E. Jones
Thomas N. Fischer
Ann K. Covington
Don A. McCubbin
James A. Offutt
H. Marshall Chatfield

Officers

The officers elected by the Board of Directors and serving, as of December 31, 2004, were as follows:

John D. Duello @	President and Chief Executive Officer
Raymond E. Jones ◈	Executive Vice President and Secretary
Don A. McCubbin	Executive Vice President
Gary D. Myers	Executive Vice President
Jerry L. French ✦	Vice President, Treasurer and Assistant Secretary
S. Daniel Clapp	Vice President – Actuarial
Max T. Dills	Vice President – Administration
Terry L. Dykes	Vice President – General Services
Thomas N. Fischer	Vice President – Investments
Gary L. Ford	Vice President – Planning and Research
Patrick D. Gruber	Vice President – Claims
William C. Keithley	Vice President – Information Services
Ricky L. Means	Vice President – Underwriting
J. David Moore # @	Vice President – Marketing
Joe L. Moseley	Vice President – Public Affairs
L. Gerald Brooks	Assistant Treasurer

J. David Moore was elected as Executive Vice President on April 6, 2005 and was replaced by C. Tyler Bailey as Vice President – Marketing.

@ Mr. Moore replaced Mr. Duello as President, effective November 19, 2005. Mr. Duello retained the CEO position.

◈ Mr. Jones retired in April 2006. Randa Rawlins, the Company's General Counsel, was elected as Secretary in April 2006 to replace Mr. Jones.

✦ Mr. French was elected as Executive Vice President, effective January 1, 2006.

Conflict of Interest

The Company has a policy that requires all officers, directors, and key employees to complete a conflict of interest statement each year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws for the examination period. There were no amendments or changes to the Articles of Incorporation during the period under examination. The Bylaws were amended and restated in February 2005 to specify the indemnification guidelines for employees, officers, and directors that are subject to litigation proceedings. The Bylaws were amended in October 2005 to add the Investment Committee as a required committee of the Board of Directors, revise the duties and requirements of elected officers, and other minor changes.

The minutes of the Board of Directors' meetings, committee meetings, and policyholders' meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

There were no acquisitions, mergers, or major corporate events during the examination period.

Surplus Debentures

No surplus debentures were issued or outstanding for the period under examination.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by the parent, Shelter Mutual, on behalf of itself, Shelter General, and its other insurance subsidiaries, for each year of the examination period.

Shelter Mutual, a property and casualty insurer, does not have any stockholders or controlling entity due to its formation as a mutual entity. The Company is ultimately owned by the policyholders of Shelter Mutual. Affiliated insurers that are also owned 100% by Shelter Mutual include Shelter Reinsurance, an international reinsurance company, and Shelter Life, a life insurance company.

Shelter General has partial ownership of the following subsidiaries:

Shelter Financial Services, Inc. (SFS) – A holding company for Shelter Benefits Management, Inc.

Shelter Benefits Management, Inc. (Shelter Benefits) – Manages various agent and employee services for Shelter Mutual employees. Services provided include human resource functions, payroll services, and benefits administration for the employees, agents, and retirees of Shelter Mutual.

Shelter Enterprises, LLC – A small entity (only $5.7 million of total assets) that owns property and equipment and derives its income from leasing the assets to affiliates, including Shelter Mutual, and non-affiliates.

Daniel Boone Underwriters, LLC (DBU, LLC) – An insurance broker that places risks from leads generated by agents of the Shelter Insurance Companies. The risks placed are in lines of business that are not written by Shelter Mutual, Shelter General or Shelter Life.

Daniel Boone Agency, Inc. – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Illinois only. This company was merged into Daniel Boone Underwriters, LLC in January 2006.

DBU, Inc. – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Mississippi only. This company was merged into Daniel Boone Underwriters, LLC in January 2006.

The operations of the Company's other affiliates are described as follows:

Shelter Financial Corporation (SFC) – A holding company for Shelter Bank.

Shelter Bank – A savings and loan company that sells certificates of deposits, individual retirement accounts, and provides auto loans and mortgage loans. It does not have any demand accounts (checking or savings). Its customers are mainly policyholders of Shelter Mutual and Shelter General, but customers may also come from the general public.

Shelter (UK) Holdings, Ltd. – A holding company for Shelter Dedicated, Ltd. and Commodore Underwriting Agencies, Ltd. The fair market value was written down to zero at the end of 2004. This entity is in the process of being dissolved.

Shelter Dedicated, Ltd. – A Lloyd's of London corporate member that accepts risks for a Lloyd's syndicate. Accepted risks for the policy year from January 1, 2001 through December 31, 2001. Due to the poor experience, no other risks were accepted after 2001. The company is now in run-off with a three-year accounting period ending December 31, 2003. It was sold to an unaffiliated entity for one British pound in December 2005.

Commodore Underwriting Agencies, Ltd. (Commodore) – An underwriter for risks taken by Shelter Dedicated, Ltd and other Lloyd's syndicates. As of the first quarter of 2003, the entity has no operations, employees, or significant assets and is pending dissolution.

Organizational Chart

The following table depicts Shelter General's ownership and holding company system, as of December 31, 2004:

Company	Parent or Controlling Entity	Ownership
Shelter Mutual Insurance Company	Policyholders	100%
Shelter General Insurance Company	Shelter Mutual Insurance Company	100%
Shelter Enterprises, LLC	Shelter General Insurance Company Shelter Life Insurance Company Shelter Reinsurance Company	45% 45% 10%
Shelter Life Insurance Company	Shelter Mutual Insurance Company	100%
Shelter Reinsurance Company	Shelter Mutual Insurance Company	100%
Shelter (UK) Holdings, Ltd.	Shelter Reinsurance Company	100%
Shelter Dedicated, Ltd.	Shelter (UK) Holdings, Ltd.	100%
Commodore UW Agencies, Ltd.	Shelter (UK) Holdings, Ltd.	62.3%
Shelter Financial Corporation	Shelter Mutual Insurance Company	100%
Shelter Bank	Shelter Financial Corporation	100%
Shelter Financial Services, Inc.	Shelter Mutual Insurance Company Shelter General Insurance Company Shelter Life Insurance Company	79.5% 11.0% 9.5%
Shelter Benefits Management, Inc.	Shelter Financial Services, Inc.	100%
Daniel Boone Underwriters, LLC	Shelter Mutual Insurance Company Shelter General Insurance Company Shelter Life Insurance Company	40% 40% 20%
Daniel Boone Agency, Inc.	Daniel Boone Underwriters, LLC	100%
DBU, Inc.	Daniel Boone Underwriters, LLC	100%

Intercompany Agreements

The Company's intercompany agreements in effect, as of December 31, 2004, are outlined below.

1. **Type:** Joint Expense Allocation Agreement

   Affiliates: Shelter Mutual, Shelter Life, Shelter Reinsurance, SFS, Daniel Boone Underwriters, LLC, Shelter Enterprises, LLC, Daniel Boone Agency, Inc., DBU, Inc., Shelter Benefits

   Effective: May 19, 1999 (original Agreement)
   December 1, 2004 (amended and restated)

   Terms: Each party agrees to pay its direct expenses in instances when each entity's actual usage can be determined. The parties agree to allocate any joint expenses for instances in which the identification and segregation of each entity's actual share is not practically feasible. The allocation methodologies for each category of joint expenses are as follows:
   (1) Personnel – estimated or actual time
   (2) Real Estate – square footage and employee count
   (3) Investment – portfolio value
   (4) Claims Adjustment (applicable to Shelter Mutual and Shelter General only) – incurred losses
   (5) Reinsurance (applicable to Shelter Mutual and Shelter General only) – actual premiums and claims of each entity
   (6) Other Expenses – assets, employee count, or written premium

2. **Type:** Tax Allocation Agreement

   Affiliates: Shelter Mutual, Shelter Life, Shelter Reinsurance, SFS, SFC, Shelter Benefits, Shelter Bank

   Effective: No stated effective date. Applicable to 1999 and subsequent tax years.

   Terms: Shelter Mutual will file a consolidated federal income tax return on behalf of itself and its subsidiaries. The tax liability for each company will be the amount that would have been determined on a separate filing basis. The subsidiaries will pay their share of tax payments to Shelter Mutual within 10 days following any tax payments made by Shelter Mutual. Shelter Mutual will refund any amount due to the subsidiaries within 10 days after filing the consolidated return.

3. Type: Agreement for Management Services and Facilities

Affiliate: Shelter Mutual

Effective: October 1, 2003 (original Agreement)
December 12, 2005 (amended and restated)

Terms: Shelter Mutual agrees to provide the employees to operate all aspects of Shelter General. Services to be provided include recordkeeping, processing, planning, budgeting, receipt and disbursement activities, and all work incidental to the operation of Shelter General's business. Shelter Mutual agrees to provide office space, utilities, computer systems, office equipment, and supplies. In exchange for the services and facilities provided, the Company will make monthly payments to Shelter Mutual. Payments will be calculated in accordance with the Joint Expense Allocation Agreement between Shelter Mutual and the Subsidiaries.

Intercompany Transactions

Shelter Mutual and Shelter General purchased structured settlement annuities from Shelter Life during the examination period. The structured settlements were used to provide periodic payouts of claim payments due under the terms of policies issued by Shelter Mutual and Shelter General. The claimants are the beneficiaries of the contracts. Shelter Mutual and Shelter General collectively paid $2,243,581, $943,754, and $2,561,350 to Shelter Life during 2002, 2003, and 2004, respectively, to purchase structured settlements.

Shelter General is a named insured on a general liability insurance policy issued by Shelter Mutual. The policy insures the premises and operations of the Shelter Mutual and all named insureds. Premium for this policy is charged to Shelter General through intercompany allocations under the Joint Expense Allocation Agreement.

The following table summarizes the payments made during the exam period, between Shelter General and its affiliates.

		Net Paid / (Received)		
Related Party	Transaction / Agreement	2002	2003	2004
Shelter Mutual	Joint Expense Allocation	$13,706,661	$16,249,793	$16,404,961
Shelter Mutual	Tax Allocation	4,707,992	5,469,370	5,753,989
Shelter Benefits	Sale / Purchase of Invest.	1,106,770	0	0
Shelter Life	Purchase of Investments	0	0	992,000
Shelter Mutual	Cash Dividend	0	0	5,000,000
Shelter Enterprises	Cash Dividends	(337,500)	(675,000)	(225,000)
DBU, LLC	Cash Dividends	(400,000)	(400,000)	(600,000)
TOTAL		$18,783,923	$20,644,163	$27,325,950

FIDELITY BOND AND OTHER INSURANCE

The Shelter Insurance Companies are named insureds on a financial institution bond. The bond provides employee fidelity coverage with a liability limit of $2,500,000 and a $50,000 deductible. This level of coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Shelter Insurance Companies are also named insureds on the following insurance policies: property, general liability, umbrella excess liability, automobile physical damage and liability (self insured), aircraft physical damage and liability, workers compensation and employers liability, computer crime, kidnap and ransom / extortion, and earth movement (self insured).

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

Shelter General does not have any direct employees or agents. Employees and agents of the parent, Shelter Mutual, perform all functions necessary for the operation of Shelter General, pursuant to the Agreement for Management Services and Facilities. Shelter General reimburses Shelter Mutual for an allocated share of the payroll and benefits costs of the employees that provide services, pursuant to a Joint Expense Allocation Agreement. Both agreements are described further in the Intercompany Agreements section of this report.

A variety of standard benefits are provided to the Shelter Mutual employees and agents. These benefits include, but are not limited to, the following: medical insurance, dental insurance, life insurance, personal accident insurance, disability insurance, sick leave, and tuition reimbursement. Employees are also provided with a defined benefit pension plan and a 401(k) savings and profit sharing plan. Certain highly compensated employees are provided with a Supplemental Employee Retirement Plan (SERP).

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2004, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities Deposit). The funds on deposit as of December 31, 2004, were as follows:

Type of Security	Par Value	Fair Value	Statement Value
U.S. Treasury Notes	$2,000,000	$2,131,100	$1,969,231

Deposits with Other States

The Company also has funds on deposit with other states. Those funds on deposit as of December 31, 2004, were as follows:

State	Type of Security	Par Value	Fair Value	Statement Value
Arkansas	U.S. Treasury Notes	$300,000	$330,294	$307,542
Louisiana	U.S. Treasury Notes	100,000	110,098	102,514
Oklahoma	U.S. Treasury Notes	300,000	330,294	307,542
Total		$700,000	$770,686	$717,598

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

Shelter General is licensed as a property and casualty insurer by the Missouri Department of Insurance under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed and writes business in Missouri and 12 other Midwestern states, as follows:

Arkansas	Indiana	Kentucky	Nebraska
Colorado	Iowa	Louisiana	Oklahoma
Illinois	Kansas	Mississippi	Tennessee

Written premiums in four states (Arkansas, Illinois, Missouri, and Tennessee) accounted for 66% of the total direct written premiums in 2004. The major lines of business for Shelter General, based upon 2004 direct written premiums, are as follows:

Line of Business	Percentage of Total Direct Written Premiums
Private Passenger Auto Liability	51.3%
Auto Physical Damage	35.4%
Commercial Auto Liability	6.2%
All Other	7.1%
Total	100.0%

Shelter General, its parent, Shelter Mutual, and its affiliate, Shelter Life, are marketed as a single business operation under the "Shelter Insurance" brand name. The property and casualty products are underwritten by Shelter Mutual and Shelter General. Shelter Mutual writes all of the homeowners policies, commercial property, and commercial liability risks for the Shelter Insurance Companies. Automobile policies for insureds with higher credit scores are assigned to Shelter Mutual and insureds with lower credit scores are assigned to Shelter General. One exception is that Shelter Mutual does not write any new auto business in Illinois and Tennessee due to requirements in those states regarding the use credit scoring for determining premium rates. Management chose to have Shelter General write all auto business in Illinois and Tennessee.

The Company's business is produced by approximately 1,300 captive agents, which also produce business for the Shelter Mutual and Shelter Life subsidiaries. The agents also cross-sell products for the Shelter Bank subsidiary. The Company also has 33 producers who sell policies through its bank alliance program with various non-affiliated banks in Oklahoma and Missouri. Employees of the banks sell products of the Shelter Companies in conjunction with auto and mortgage loans financed by the banks. The Company has a marketing staff that uses various methods of advertising and direct mailings to promote the products of Shelter General and its affiliates.

Policy Forms & Underwriting;
Advertising & Sales;
Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent MDI market conduct examination report was dated April 25, 2002, and covered the period from October 1, 2000 to September 30, 2001. No significant problems were noted from review of this report.

REINSURANCE

General

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	2002	2003	2004
Direct Business	$90,338,194	$92,990,223	$95,116,692
Reinsurance Assumed:			
Affiliates	0	0	0
Non-affiliates	0	9,370	11,795
Reinsurance Ceded:			
Affiliates	(392)	0	0
Non-affiliates	(583,720)	(862,542)	(646,995)
Net Premiums Written	**$89,754,082**	**$92,137,051**	**$94,481,492**

Assumed

The Company does not assume any business, except from involuntary pools and associations.

Ceded

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

Shelter General has several joint ceded reinsurance agreements in which the Company's parent, Shelter Mutual, is also a named reinsured in the agreements. However, Shelter General has very little or no written premium for the lines of business covered in several of these agreements. For the agreements that are applicable to Shelter General, it does not directly pay reinsurance premiums to the reinsurers and does not directly receive loss recoveries. Rather, Shelter Mutual pays the total premium to the reinsurers on behalf of itself and Shelter General. Likewise, any loss recoveries are paid directly to Shelter Mutual. Shelter General is allocated reinsurance premiums and loss recoveries, pursuant to terms of the Joint Expense Allocation Agreement that is described in the Intercompany Agreements section of this report.

Shelter General has limited ceded reinsurance activity due to the auto business that accounts for nearly all of its direct premiums. The policy limits for auto property coverage are retained 100% by the Company, except in instances when a catastrophe occurs. The Company only reported ceded loss reserves of $500,000, as of December 31, 2004. This amount is for liability risks that are ceded to one reinsurer, Employers Reinsurance Corporation (ERC).

Shelter General and its parent, Shelter Mutual, have an excess reinsurance agreement, originally effective January 1, 1975, with ERC that appears to cover auto liability and general liability risks. The reinsured lines of business, the retention, and the reinsurance limits are not clearly defined because of the 50 amendments that have taken place since the inception of the agreement in 1975. Per the Company, the first layer covers $2,000,000 of risk in excess of a retention of $500,000 per occurrence. The Company stated that the second layer covers the next $2,000,000 of risk in excess of the first layer retention of $2,500,000. The terms of the agreement are subject to interpretation because it is impossible to tie together the disjointed and confusing terminology from all of the amendments and the original body of the agreement together in a coherent manner. As recommended in the prior examination, it is once again recommended that this agreement be restated in its entirety so that the reinsured lines of business, retentions, and limits are clearly defined.

Shelter General and Shelter Mutual have a five-layer catastrophe program that is implemented by two separate agreements with several participating reinsurers. Both agreements cover all property risks including auto physical damage. The first four layers are contained in a catastrophe excess of loss agreement, effective January 1, 2004, with 22 reinsurers. The participation of each reinsurer is defined in an Interest and Liabilities Agreement with each reinsurer. Two Bermuda companies, XL Re, Ltd. and Ace Tempest Reinsurance Company, Ltd., were the two largest participants in the 2004 agreement for the first four layers. The fifth layer is included in a catastrophe excess of loss agreement, effective January 1, 2004, with the Mutual Reinsurance Bureau, which is an association of three U.S. insurers (Auto-Owners Insurance Company, Employers Mutual Casualty Company, and Motorists Mutual Insurance Company).

The reinsurance coverages for the combined subject net losses of Shelter Mutual and Shelter General for each layer are as follows:

Layer	Subject Net Losses	Reinsurance %
First	$15,000,000 excess of $35,000,000	95%
Second	$30,000,000 excess of $50,000,000	95%
Third	$40,000,000 excess of $80,000,000	95%
Fourth	$65,000,000 excess of $120,000,000	95%
Fifth	$20,000,000 excess of $185,000,000	100%

The two catastrophe agreements are renewed each year. The amount of risks contained in each layer were not changed for 2005, but the retentions for Shelter General and Shelter Mutual were increased in comparison to the 2004 retentions. Effective with the January 1, 2005 renewal, the reinsurance coverages for the combined subject net losses of Shelter General and Shelter Mutual for each layer are as follows:

Layer	Subject Net Losses	Reinsurance %
First	$15,000,000 excess of $35,000,000	47.5%
Second	$30,000,000 excess of $50,000,000	85.0%
Third	$40,000,000 excess of $80,000,000	85.5%
Fourth	$65,000,000 excess of $120,000,000	90.0%
Fifth	$20,000,000 excess of $185,000,000	100.0%

Effective with the January 1, 2006 renewal, the reinsurance coverages for the combined subject net losses of Shelter General and Shelter Mutual for each layer are as follows:

Layer	Subject Net Losses	Reinsurance %
First	$15,000,000 excess of $35,000,000	40.4%
Second	$30,000,000 excess of $50,000,000	80.8%
Third	$40,000,000 excess of $80,000,000	81.2%
Fourth	$65,000,000 excess of $120,000,000	85.5%
Fifth	$25,000,000 excess of $185,000,000	100.0%

ACCOUNTS AND RECORDS

General

The CPA firm, PricewaterhouseCoopers, LLP, (PWC) of St. Louis, Missouri, issued audited statutory financial statements of the Company for 2002 and 2003. The CPA firm, Ernst & Young, LLP, of Kansas City, Missouri, issued the audited financial statements of the Company for 2004. The Company stated that the change of CPA firms was strictly due to a competitive bid process and that there was no disagreement or issues with PWC that led to the change.

The reserves for losses and loss adjustment expenses (LAE) were reviewed and certified by Terrence M. O'Brien, FCAS, MAAA, CPCU for the years ending December 31, 2002 and December 31, 2003. Mr. O'Brien is employed by the Chicago, Illinois office of PWC. The reserves for losses and LAE were reviewed and certified by Robert Wainscott, FCAS, MAAA for the year ending December 31, 2004. Mr. Wainscott is employed by the Ernst &Young, LLP office in Chicago, Illinois.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Shelter General for the period ending December 31, 2004. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Notes to the Financial Statements." The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

Assets
as of December 31, 2004

	Assets	Non-Admitted Assets	Net Admitted Assets
Bonds	$129,322,734	$0	$129,322,734
Common Stocks	19,669,678	0	19,669,678
Cash and Short-Term Investments	6,227,688	0	6,227,688
Other Invested Assets	2,616,247	0	2,616,247
Investment Income Due and Accrued	2,156,618		2,156,618
Uncollected Premiums and Agents' Balances in the Course of Collection	544,336	0	544,336
Deferred Premiums, Agents' Balances and Installments Booked But Deferred and Not Yet Due	8,661,148	0	8,661,148
Amounts Recoverable from Reinsurers	207,646	0	207,646
Guaranty Funds Receivable or on Deposit	266,979	18,541	248,438
Receivable from Parent, Sub., and Affiliates	2,711	0	2,711
Agg. Write-Ins for Other than Invested Assets:			
Equities and Deposits in Pools and Assoc.	14,088	0	14,088
Miscellaneous Accounts Receivable	232	0	232
TOTAL ASSETS	**$169,690,105**	**$18,541**	**$169,671,564**

Liabilities, Surplus and Other Funds
as of December 31, 2004

Losses **(Note 1, 2)**	$ 38,894,120
Loss Adjustment Expenses **(Note 1)**	7,752,857
Commissions Payable	2,788,807
Other Expenses	46,673
Taxes, Licenses and Fees	534,360
Federal Income Taxes	863,588
Net Deferred Tax Liability	1,240,012
Unearned Premiums	23,497,964
Advance Premium	2,681,838
Ceded Reinsurance Premiums Payable	18,222
Amounts Withheld or Retained	69,179
Remittances and Items Not Allocated	204,852
Drafts Outstanding	3,983,527
Payable to Parent, Subsidiaries and Affiliates	1,784,753
Aggregate Write-Ins for Liabilities:	
Catastrophe Reserves	672,341
Escheated Checks	1,830
TOTAL LIABILITIES	**$85,034,923**
Common Capital Stock	1,250,000
Unassigned Funds (Surplus)	83,386,641
Surplus as Regards Policyholders	**$84,636,641**
TOTAL LIABILITIES AND SURPLUS	**$169,671,564**

Statement of Income
For the Year Ended December 31, 2004

Premium Earned	**$93,628,581**
DEDUCTIONS:	
Losses Incurred	52,146,719
Loss Expenses Incurred	8,194,619
Other Underwriting Expenses Incurred	24,190,496
Aggregate Write-Ins for Underwriting Deductions	418,948
Total Underwriting Deductions	**$84,950,782**
Net Underwriting Gain	**$ 8,677,799**
Net Investment Income Earned	7,958,033
Net Realized Capital Gains	1,087
Net Investment Gain	**$ 7,959,120**
Other Income	345,082
Federal Income Taxes Incurred	5,399,748
Net Income	**$11,582,253**
CAPITAL AND SURPLUS ACCOUNT:	
Surplus as Regards Policyholders, December 31, 2003	$76,780,482
Net Income	11,582,253
Change in Net Unrealized Capital Gains or (Losses)	1,066,853
Change in Net Deferred Income Tax	182,043
Change in Non-Admitted Assets	25,007
Dividends to Stockholders	(5,000,000)
Surplus as Regards Policyholders, December 31, 2004	**$84,636,638**

Notes to the Financial Statements

Note 1 – Losses **$38,894,120**

Schedule P of the 2005 Annual Statement reported adverse loss development of $16,186,000 for the Loss and LAE reserves, reported as of December 31, 2004. This represents a 35% reserve deficiency. Thus, based upon 2005 development, the Loss and LAE reserves should have been $16,186,000 greater than the amounts recorded by the Company. As a result of this adverse loss development, capital and surplus decreased from $84,636,641, as of December 31, 2004, to $76,157,000, as of December 31, 2005. This represented a 10% decrease in capital and surplus.

A jury verdict issued against Shelter General on December 9, 2005 from a policyholder lawsuit was the main reason for the significant adverse loss development. The action arose from an automobile accident involving the policyholder that occurred in August 1998. The verdict awarded the policyholder $6,285,002 in compensatory damages and an addition $3,000,000 in punitive damages. The Company is appealing the verdict, as of the date of this report. However, if the appeal is not successful, the Company estimated the total judgement with interest will be approximately $10,500,000. The remaining $6 million in adverse development was due to increased reserves for other pending litigation.

The Company did not have reinsurance coverage in 1998 to guard against exposures from large judgements from legal proceedings. However, an amendment was added to a reinsurance agreement with ERC in 2003 that covers 90% of any compensatory or punitive damages that are incurred by Shelter General. The Company appears to currently have adequate reinsurance to prevent such a negative impact on capital and surplus, if a similar adverse judgement should occur in the future.

Note 2 – Losses **$38,894,120**

The Company issues drafts instead of checks to pay claims. At the time a draft is issued, the reserve for a claim is eliminated from the Losses line and a liability is established in the Drafts Outstanding line. A draft is voided if it is not presented for payment within 180 days of issuance. The Company records a negative claim expense and reverses the liability from the Drafts Outstanding line when a draft is voided. The Company does not reestablish a reserve or any other liability for claims that have had a voided draft, even though the claim has not been paid.

An accounting gap has been created from the fact that drafts are "offers for settlement" instead of being "payable on demand" checks. If the Company were to use checks to settle claims, there would always be a liability for the claim on the balance sheet in the form of an outstanding check in the cash balances or an escheatment liability to various states. Once a draft is voided, the liability to pay the claim disappears from the Company's balance sheet. Paragraph 5.a. of Statement of Statutory Principle (SSAP) No. 55, Unpaid Claims, Losses, and LAE, requires a liability to be recorded in the Losses for any unpaid losses. Voiding a draft does not dismiss the liability to pay the claim.

The Company believes that the Incurred But Not Reported (IBNR) reserve component in the Losses line will properly account for the liability for voided drafts. However, there is no separate provision to account for claims with voided drafts in the IBNR calculation and the Company failed to explain how IBNR would cover the liabilities for these claims. The Company could not provide any data on the amount of voided drafts each year or the cumulative liability that remains at December 31, 2004. Although the cumulative liability for unpaid claims with voided drafts is probably immaterial, a proper risk assessment could not be made due to the lack of information. It is certain that the Company has unrecorded liabilities for some claims, but there are apparently no controls in place to track or determine the amount.

The Company is directed to determine, as of December 31, 2004, the cumulative amount of claim drafts that had previously been voided, but not reissued. The Company is further directed to maintain a running balance of voided claim drafts that have not been reissued at the end of each month. Liabilities should be recorded in the Losses line, in accordance with SSAP No. 55, for the amount of unpaid claims relating to the voided drafts.

Examination Changes

None.

General Comments and/or Recommendations

Reinsurance Agreement with ERC (page 17)

The Company's excess reinsurance agreement with ERC, originally effective January 1, 1975, is disjointed and has confusing terminology. The 50 amendments to this agreement cannot be tied to the body of the original agreement in any coherent manner. As a result, the reinsured lines of business, the Company's retention, and the reinsurance limits are not clearly defined. It is recommended that this agreement should be restated in its entirety so that the reinsured lines of business, retentions, and limits are clearly defined.

Voided Drafts (page 23 and 24)

The Company is directed to determine, as of December 31, 2004, the cumulative amount of claim drafts that had previously been voided, but not reissued. The Company is further directed to maintain a running balance of voided claim drafts that have not been reissued at the end of each month. Liabilities should be recorded in the Losses line, in accordance with SSAP No. 55, for the amount of unpaid claims relating to the voided drafts.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Shelter General Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Shawn Hernandez, CFE, Shannon Schmoeger, CFE, Larry Kleffner, CFE, Karen Baldree, CPA, CFE, Al Garon, CFE, and Andy Balas, CFE, examiners for the Missouri Department of Insurance, also participated in this examination. The firm of Expert Actuarial Services, LLC, also participated as a consulting actuary.

VERIFICATION

State of Missouri)
)
County of Boone)

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Shelter General Insurance Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim L. Tunks
Tim L. Tunks, CPA, CFE
Examiner-In-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this 21st day of June, 2006.

My commission expires: May 1, 2008 Debbie J. Nolke
Notary Public

DEBBIE J. NOLKE
Notary Public - Notary Seal
STATE OF MISSOURI
County of Boone
My Commission Expires May 1, 2008

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Frederick G. Heese
Frederick G. Heese, CFE, CPA
Audit Manager
Missouri Department of Insurance

SHELTER INSURANCE COMPANIES

J. DAVID MOORE
PRESIDENT
(573) 214-4568
FACSIMILE: (573) 214-6363

RECEIVED
MO INS DEPT
AUG 21 2006

August 16, 2006

Kirk Schmidt, CFE, CPA
Chief Financial Examiner
State of Missouri
Department of Insurance
P.O. Box 690
Jefferson City, Missouri 65102-0690

Dear Mr. Schmidt:

I received your letter of August 10, 2006, along with a draft copy of the Examination Report of Shelter General Insurance Company for the period ending December 31, 2004. As requested, I am providing the Company's responses to the comments on page 25 of the Examination Report. I also note an additional correction regarding page 18.

It is requested that the Company's response be included in the Report as a public document.

Sincerely,

J. David Moore

J. David Moore
President and Chief Operating Officer

JDM:mta

Attachment

**RESPONSES OF SHELTER GENERAL INSURANCE COMPANY
TO THE
GENERAL COMMENTS AND/OR RECOMMENDATIONS
OF THE EXAMINATION REPORT
OF SHELTER GENERAL INSURANCE COMPANY
FOR THE PERIOD ENDING DECEMBER 31, 2004**

Page 18 **Effective January 1, 2006 the second layer of the catastrophe agreement is 95% covered, not 80.8%.**

Comment: **Reinsurance Agreement with ERC (Page 25)**

The Company agrees this is a longstanding agreement with our reinsurer. Since inception the breadth of coverage has actually decreased, to cover only casualty risks, making the agreement simpler. Much of the endorsement volume relates to normal rate adjustments through the years. Neither Shelter nor the vendor finds the agreement difficult to understand as evidenced by the lack of disagreements as to the reinsured lines of business, retentions, or limits during the past 30 years. The age of the agreement actually is to Shelter's benefit as the agreement provides coverage that would be difficult to replace in today's market. The Company will most certainly strive to make a subsequent agreement easier to read when a compelling business reason to change occurs.

Comment: **Voided Drafts (Page 25)**

The Company certainly agrees with the Department's position as outlined in this comment and pages 23 and 24 dealing with the necessity to maintain adequate overall reserves in accordance with SSAP No. 55. A review of our Annual Statements reveals that in 9 of the past 10 years the Company has recorded redundant reserves. The one year with deficient reserves was the result of an extra contractual loss and had nothing to do with voided drafts.

Claim loss reserving is the science of establishing reasonable estimates of a large number of unknown costs associated with a given set of insurance policies. SSAP No. 55 outlines the general categories of costs to be included and allows several methodologies to be followed in making the final estimates. The generally accepted purpose of the incurred but not reported (IBNR) loss category is to reflect the value of

- losses that have not been reported to the company,
- losses which have been reported but have not been recorded by the company,
- losses that have been reported & recorded by the company at inadequate values,
- losses that have been adjusted and erroneously closed with exposure existing,

- inflation on future loss settlements,
- additional costs associated with a change in the legal environment.

The exposure value of voided drafts clearly falls in the category covered by the IBNR reserve and this is where Shelter maintains such liability. The Company's IBNR calculation is performed as a bulk calculation which is acceptable under SSAP No. 55. This means that none of the various exposures for which IBNR is designed to cover are individually tracked. Such detail is not operationally necessary or required by statutory accounting.

Shelter will continue to conservatively record loss reserves in accordance with generally accepted actuarial standards with attestations by a Fellow of the Casualty Actuarial Society.